United States Court of Appeals

for the Second Circuit

BRIEF FOR APPELLEE

77-7125

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DOROTHY L. COLE, LOIS ZISOOK, HARRY W. VOEGE and ANNA MAY TUNMORE, as Trustees, SAMUEL GREENFIELD FUND, INC. and HAROLD STILLER and MILDRED STILLER, as joint tenants,

Plaintiffs,

DOROTHY L. COLE, HARRY W. VOEGE, and ANNA MAY TUNMORE, as Trustees, and HAROLD STILLER and MILDRED STILLER, as joint tenants,

Plaintiffs-Appellants,

v.

SCHENLEY INDUSTRIES, INC., GLEN ALDEN CORPORATION, RAPID-AMERICAN CORPORATION, ISIDORE A. BECKER, BERNARD GOLDBERG, PAUL A. JOHNSTON, DAVID A. CHERNOW, WALTER O. HEINZE, HOWARD FELDMAN, MILO B. HOPKINS, RUSSELL G. SMITH, ALBERT N. GREENFIELD, MESHULAM RIKLIS, GLEN ALDEN SUBSIDIARY, INC., P. J. CLIFFORD, W. P. JOHNSON, S. KITTAY, M. L. MENDELL, L. C. LANE, G. H. PERKINS and B. DENMARK,

Defendants-Appellees.

BRIEF OF THE APPELLEES

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UNITED STATES COURT OF APPEALS
FILED
MAY 27 1977
A. DANIEL FUSARO, CLERK
SECOND CIRCUIT

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Defendants-Appellees.

BRIEF OF THE APPELLEES

Counterstatement of Issues Presented

1. Was it reversible error for the District Court to find that the proxy statement dated May 21, 1971 (the "proxy statement") did not violate §§ 14(a) and 10(b) of the Securities Exchange Act of 1934?

2. Did the District Court abuse its discretion in dismissing the alleged pendent common law claims that the merger of Schenley Industries Inc. ("Schenley") and Glen Alden Corporation ("Glen Alden") was "unfair"?

3. Was it reversible error for the District Court to dismiss the alleged "third party beneficiary" claim asserted by plaintiff Voege?

Counterstatement of the Case

This action was tried to the Court for a period of seven days, almost all of which was devoted to the presentation of evidence by plaintiffs*. In the submissions made before trial and during the presentation of evidence, plaintiffs made a broadside attack on the proxy statement and accused defendants of a plethora of alleged violations of the securities laws with respect to many aspects of Schenley. By the conclusion of the trial (and continuing through this appeal), plaintiffs had reduced the focus of their attack to their claims concerning Schenley's alleged "excess" cash, a subject which as plaintiffs themselves demonstrated in their attempts to enjoin the merger was fully disclosed in the proxy statement. Indeed, as the District Court found, amply supported by the record, the facts relevant to Schenley's cash position were adequately disclosed in the proxy statement and plaintiffs claims amounted to no more than a desire to have defendants affix labels and opinions to disclosed facts.

Background

At all times Schenley's primary business was the manufacture, importation, and sale of distilled spirits. Until

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* Pursuant to Pre-trial Order dated October 9, 1975 only the issue of liability was tried. Such Order is designated as appearing at page 109 of the Appendix but has not been reproduced by plaintiffs.

the time of the merger the common and $1.40 Preferred ("preferred") stock of Schenley were listed and traded on the New York Stock Exchange* (A110).

Starting sometime in 1967, Glen Alden was involved in a bidding contest for control of Schenley. In March, 1968 Glen Alden purchased 18% of Schenley's common stock from Lewis S. Rosensteil, the founder and chairman of the Board of Schenley. Subsequently, in August, 1968 Glen Alden made an exchange offer to all stockholders of Schenley. As a result of this offer, Glen Alden became the holder of approximately 88% of the common stock of Schenley (Op 3, A110).

Since 1964 Schenley had owned 52.7% of the stock of the Buckingham Corporation ("Buckingham") whose sole business was the importation and sale of Cutty Sark Scotch Whisky. As a result of a merger in 1969, Schenley became the owner of all of the stock of Buckingham. Former stockholders of Buckingham received preferred stock of Schenley which was convertible into 9/10 of a share of Schenley Common Stock. These preferred stockholders made up approximately ⅔ of the plaintiff class in this action.

A consent decree in an anti-trust action compelled Schenley to divest itself of Buckingham. In October, 1970 Schenley announced the proposed sale of Buckingham to Northwest Industries for approximately $120 million. The sale was effectuated in May, 1971 (A110.22).

On February 25, 1971 Glen Alden announced the terms of the proposed merger; to wit, $5 in cash and a $30 face

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* References denoted (A) are to the Joint Appendix. References denoted (Op) are to the opinion of the District Court. (T) are to the transcript of the trial and (Ex) shall indicate exhibits offered at the trial.

amount 7½% debenture for each share of Schenley common stock and $4.50 in cash and a $27 face amount 7½% debenture for each share of preferred* (A110.2). This package, it is undisputed, had a fair market value of $29 per share for common stock and $26.10 for preferred. This consideration represented a price in excess of the market price of Schenley stock for almost 2 years (and higher than the market price at any point for 10 years except during the bidding contest for control of Schenley) and greater than the market price of Buckingham for over 5 years (Op 4).

Prior Litigation

Several lawsuits were commenced by stockholders attacking the merger. Three applications were made to enjoin the merger; two by the plaintiffs (Voege and Zisook) in the instant action and one in the Chancery Court of Delaware. All three applications were denied.

In the first of the three applications, *Voege* v. *Smith,* 329 F.Supp. 180 (S.D.N.Y. 1971), the District Court dealt with both the claims of lack of disclosure and the issue of the fairness of the merger. On the question of nondisclosure, the Court held:

> "In the case at hand the plaintiffs have been informed of all the facts relating to the transaction and have, by the proxy material issued in connection with the merger, been 'sufficiently alerted' to Glen Alden's 'active interest in promoting the merger' as well as the details of this very lawsuit and a number of similar pending actions." (329 F.Supp at 183)

The Court considered at length the question of whether "the terms of the Plan are fair to the plaintiffs and their

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* Glen Alden had sufficient voting power to ensure the consummation of the merger.

class'' and held that ''Even as to this narrow issue, the plaintiffs have not established, to the degree necessary to sustain the granting of a preliminary injunction, the probability that they will succeed'' (at 184).

The Court of Chancery of Delaware considered an extensive and detailed attack—supported by an expert's affidavit of approximately 50 pages—on the fairness of the merger in *David J. Greene & Co.* v. *Schenley Industries, Inc.*, 281 A.2d 30 (Del. Ch. 1971). The Court considered virtually every argument and contention made by plaintiffs in this action. The Court found that defendants had sustained the burden of showing the merger to be fair, placing special emphasis on the importance of the market price of Schenley. Accordingly, the Court permitted the merger to be consummated and relegated plaintiff to its statutory right of appraisal, stating:

> ''While a court of equity should stand ready to prevent corporate fraud and any overreaching by fiduciaries of the rights of stockholders, . . . by the same token this Court should not impede the consummation of an orderly merger under the Delaware statutes, an efficient and fair method having been furnished which permits a judicially protected withdrawal from a merger by a disgruntled stockholder.'' (281 A.2d at 36)

The final attempt to enjoin the merger was made by plaintiff *Zisook*. This application was denied without opinion by Chief Judge Sugarman.

Subsequent to the consummation of the merger, statutory appraisal proceedings were commenced in the Chancery Court. The decision of the Court was handed down in *Gibbons* v. *Schenley Industries, Inc.*, 339 A.2d 460 (Del. Ch. 1975). Although Delaware appraisal proceedings are

governed by particular formulae which require the Court to give separate weights to different factors and do not accord with general concepts of valuation (See for example *Chris-Craft Industries, Inc.* v. *Piper Aircraft Corp.*, 516 F.2d 172 (2nd Cir. 1975), *rev'd*, 45 U.S.L.W. 4182 (Feb. 23, 1977), the decision in *Gibbons* is in accord with the prior decisions relating to the merger. Applying the Delaware formulae, the Court found a value for common stock of $33.86 and for preferred stock of $30.47. The Court found that Schenley's market price was entitled to a weight of 55%, the highest ever given in a Delaware appraisal proceeding. The Court noted the challenges to market price and stated: "In fact, many of the contentions made by exceptants here evoke the feeling of deja vu in light of the rulings in the cited cases" (339 A.2d at 466n). Finally, although the claimants in *Gibbons*, like plaintiffs here, placed particular emphasis upon the so-called "asset value" of Schenley, the Court refused to give any weight to "asset value".*

The Proxy Statement

For the first time since this litigation began in 1971 plaintiffs have conceded the existence of portions of the Proxy Statement other than those they attack. (App. Br. p.28). Nevertheless, they continue to give short shrift to even those portions that plaintiffs characterize as a "fulsome warning." Since this action is about the entire Proxy Statement we think it important to review all of the salient parts of that document.

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* The Court noted: "In other words, the investing and trading public, in reaching a judgment as to the value of corporate shares, gives consideration to corporate assets only insofar as they disclose a capability of generating earnings, a judgment exercised here . . ." (at 473). The Court also cited Graham, Dodd, Cottle & Tatham, *Securities Analysis*, p. 519 for the proposition that cash assets bring in little or no earnings.

It is important to note what the proxy statement does *not* contain. One can search this document in vain in an attempt to find any portion of it designed to sell, promote or recommend the merger. At no point can any part of the proxy be interpreted as urging stockholder approval or encouraging stockholders not to exercise any of their legal rights. Indeed, it is clear that the proxy was intended to and did present every aspect of the merger and every material fact giving emphasis to the negative aspects of the merger from the point of view of the minority stockholder.

The proxy statement contains, as required by law, full descriptions of the business and operations of Schenley and Glen Alden, together with certified financial statements for both companies. In addition, the proxy statement contains a statement of "Consolidated Changes in Working Capital for Schenley" which in essence, provides a full picture of the cash flow of Schenley since 1968. These sections of the proxy, which have not been challenged by plaintiffs, provide a shareholder with complete information about the financial condition of both Schenley and Glen Alden.

At every opportunity the proxy statement discloses and highlights those factors which would be most likely to lead a shareholder to critically scrutinize the merger. This is best shown by the very first page of the proxy statement. There, in bold type, the proxy statement presents three separate warnings to shareholders. First, the proxy statement notes that Glen Alden has elected the directors of Schenley and has the voting power to effect the merger and states: **"Under the circumstances, stockholders of Schenley might desire to give the terms of and the consequences resulting from, the proposed reorganization more careful scrutiny than they would if the proposed reorganization**

had been negotiated and approved by an entirely disinterested and independent Board of Directors". (A950) (Emphasis in original).

Immediately thereafter, again in bold type, the proxy statement warns shareholders of one immediate consequence of the merger, to wit, the transfer of funds from Schenley to Glen Alden, stating: **"Schenley will transfer to Glen Alden substantial funds of Schenley, including a substantial part of the proceeds received by Schenley from the recent sale of its subsidiary, the Buckingham Corporation."** (A950) (Emphasis in original). Again, still on the first page of the proxy statement, and in bold type, two more warnings are given. First, the attention of shareholders is called to the fact that litigations had been brought seeking to enjoin the proposed reorganization and they are directed to review a description of those litigations. Indeed, shareholders are warned—again in bold type—that they should carefully consider the procedures for seeking an appraisal of the value of their shares. (A950)

The strength of the warnings given at the very beginning of the proxy statement is continued throughout the document. Particularly noteworthy is the section entitled "Certain Significant Aspects of the Proposed Reorganization" prominently featured starting on page 3 of the proxy (A952). Once again, shareholders are informed that substantial funds of Schenley will be transferred to Glen Alden for the purpose of providing general working capital and as a source for payment of current maturities of Glen Alden long term debts. This same section also contains a comparison of the liquidity position of Glen Alden and Schenley taking account of the sale of Buckingham. This comparison shows that Schenley had cash and near cash assets of $162,000,000 as opposed to $39,000,000 for Glen Alden, net quick assets of $111,000,000 as com-

pared to minus $65,000,000 for Glen Alden and no current maturities of long term debts as opposed to $77,000,000 for Glen Alden. Thus, the proxy left no doubt as to the relative liquidity of the two companies.

This same section notes particularly that the consideration being offered in the merger is "substantially less" than the amounts paid by Glen Alden in 1968 when it acquired its controlling interest in Schenley (A953). It further notes any conflict of interest that could be present in the transaction and makes a complete disclosure of all relationships between Allen & Company (the advisor to Schenley on this merger) and any company affiliated with Glen Alden (A954).

One of the most significant portions of the proxy statement is the description of the litigations with respect to the merger. Each of the litigations, including the constituent actions now pending before the Court, are fully disclosed, and all of the material allegations made by the plaintiffs are set forth (A957-960). This section makes it clear that the plaintiffs in those actions were claiming that Schenley stock and the assets and earnings and business of Schenley were worth substantially more than the consideration being offered in the merger. Indeed, the proxy specifically sets forth what each plaintiff was claiming with respect to the value of Schenley stock. There could be no doubt in the mind of a shareholder that a group of shareholders was asserting that a share of Schenley was worth in excess of $50, and accordingly, each should consider the desirability of exercising his or her appraisal rights under Delaware law.

The financial information in the proxy statement is not limited to the certified financial statements for the year ended December 31, 1970. Special attention is given to the effect of the sale of Buckingham, which eliminated a ma-

terial part of Schenley's business while providing Schenley with substantial amounts of cash. This is found on pages 42-44 of the proxy statement (A991-993). In addition to a full description of the sale, the proxy statement shows a pro forma income statement based upon assumptions regarding the use of the proceeds from the sale of Buckingham, while at the same time making it clear again that a substantial portion of the proceeds of the sale would be transferred to Glen Alden upon the merger. In addition, the proxy shows the balance sheet effect of the sale of Buckingham, both in terms of the increased liquidity of Schenley and the increase of its book value from $33.52 per share to $40.44 per share.

Schenley's Cash Position

As the District Court found (Op 2) there is no question that Schenley was a "cash rich" company at the time of the proxy statement. The facts about Schenley's cash position and the sources of the growth of Schenley's cash are not in dispute. Thus, before dealing with plaintiffs' separate, albeit interrelated allegations, it is important to review these facts and the nature of the disclosures about Schenley's cash.

As required by law (see Item 15 of S.E.C. Form 14a) the proxy statement contains Schenley income statements for five years and audited balance sheets for the years 1969 and 1970 (A1039-1048). Each balance sheet sets forth Schenley's cash balance as of the appropriate date and the amounts of Schenley's assets in the form of certificates of deposit and marketable securities. The balance sheets also list under the category of "Investments" the Glen Alden 6% Debentures previously purchased by Schenley. Plaintiffs concede the accuracy of these figures (A852-855).

Although the proxy statement does not contain audited financial statements for years before 1969, Schenley's financial position was reported—concededly accurately—in Schenley's prior financial statements (Exs. 7-9 A1340, 1364.) Thus, the proxy statement issued in connection with the 1969 merger involving Buckingham and Schenley (Ex. 2 A1073) contains financial statements for 1968 and the August, 1968 prospectus (Ex. 3 A1172) issued in connection with Glen Alden's exchange offer to all Schenley shareholders contains Schenley audited financial statements for 1967 as well as an unaudited financial statement for three quarters ended May 31, 1968. Since at the time of these financial reports Buckingham was not a wholly-owned subsidiary, a separate Buckingham financial statement is presented although, of course, the Schenley consolidated financial statements include the assets and liabilities of Buckingham (A1129, 1265).

In addition to financial statements, the proxy statement contains a Statement of Consolidated Changes in Working Capital on page F-27 (A1042). This Statement shows changes in Schenley's working capital as a whole, and specifically shows the changes in the components of working capital including cash, certificates of deposit, marketable securities and investments from the year ended August 31, 1968 to December 31, 1970.*

There has never been any dispute that the financial statements found in the proxy statement accurately reflect Schenley's cash and liquidity as of December 31, 1970. From that time until the consummation of the merger,

* Although plaintiffs do not challenge the accuracy of this Statement, they have sought to minimize its importance by suggesting that there was very little change in *total* working capital. Of course, any shareholder could review the *specific* items in the Statement, particularly the item of "cash" and see substantial changes from 1968 to 1970.

there was only one event which significantly altered Schenley's liquidity and which, in fact, contributed the great preponderance of Schenley's cash. That event, of course, was the sale of Buckingham for cash and near cash assets totalling $120 million (A110.22).

Although operated as a separate entity, Buckingham was the single largest contributor to Schenley's earnings. Obviously, its sale had a most substantial effect on Schenley's liquidity. The sale, its terms, and financial effect are disclosed at ten different points in the proxy statement (A950, 952, 953, 964, 973, 974, 975, 991-993, 1031, 1047) including pro forma financial statements showing the effect of such sale on prior income and Schenley's book value A992-993). A specific analysis of the effect of the sale on Schenley's cash position is found on page 3 of the proxy statement (A952) where the liquidity of Schenley and Glen Alden is compared. This comparison shows that Schenley had, on a pro forma basis (assuming Buckingham was sold in 1970) $162 million of cash, certificates of deposit and marketable securities as of December 31, 1970. As the proxy statement makes clear, this figure is computed by taking those assets as reported in the December 31, 1970 audited financials (approximately $72 million) and adding to it the net proceeds from the sale of Buckingham, less certain identified sums required for the payment of taxes and repayment of debt.

Plaintiffs have not challenged the accuracy of any of the financial information cited above. Instead, they choose an entirely different document as the basis for all of their arguments in this case—the Schenley internal unaudited balance sheet of May 31, 1971 (Ex. 17-B, A1402) a document that was prepared well after the mailing of the proxy statement on May 21, 1971 and, indeed, speaks as of a date after such mailing. Plaintiffs contend, based upon their

interpretation of Exhibits 17-B, that Schenley had $191 million in cash and near cash assets* as compared to the figure of $162 million shown on page 3 of the proxy statement, although they do not contend that this difference had any independent significance. Since the May 31, 1971 balance sheet is the subject of extensive discussion by plaintiffs, it is useful to review the salient feature of that document and how it differs from the pro forma financial information on page 3 of the proxy statement. Such a review demonstrates that the conclusions and comparisons plaintiffs attempt to make about Schenley's cash position are simply incorrect.

1. The May 31, 1971 balance sheet contains the gross proceeds from the sale of Buckingham and no amount has been subtracted for tax liability or even for the required repayment of debt (A550). The gross proceeds of the sale were $120 million. At the time of sale, Buckingham had approximately $6 million of cash (A1400.21). Thus, the net cash increase on Exhibit 17-B is $114 million, although concededly, Schenley was required to utilize a portion of that cash to meet tax, debt, and other obligations. Of course,

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* For the first time in this action plaintiffs contend (App. Br. pg. 29) that their figure of $191 million does not come from an internal balance sheet but from the proxy statement itself. Indeed, plaintiffs chide Judge Owen for failing to discern how that figure came from the proxy statement. The exhibits submitted by plaintiffs in support of this figure are all based upon the May 31, 1971 balance sheet (A1434, A1435). Plaintiffs' expert testified that he obtained this figure from the same balance sheet (A823). At every point in this case plaintiffs have identified this balance sheet as the source of their contention about Schenley's cash. Plaintiffs cite nothing in the record to support this new position. Indeed, it is incredible to believe that financial statements of December 31, 1970, as are contained in the proxy statement, could, as plaintiffs apparently now claim, contain the same figures as a balance sheet prepared five months later. One need only compare the two balance sheets to see substantial differences. This last minute attempt to attack the District Court's decision is as insulting as it is inaccurate.

page 3 of the proxy statement takes such requirements into account.

2. Page 3 of the proxy statement speaks as of December 31, 1970. Since Exhibit 17-B is a May 31, 1971 balance sheet, it includes all changes in cash for the first five months of 1971. A comparison of Schenley's financial statements with this Exhibit shows a reduction of approximately $20 million in cash during the period prior to the sale of Buckingham with some increase due to operating earnings. Thus, absent the Buckingham proceeds, Exhibit 17-B shows a lower cash balance (by approximately $12 million) than the December 31, 1970 balance sheet.

3. When plaintiffs speak of Schenley's cash, they include Schenley's investment in Glen Alden 6% Debentures, apparently on the theory that such debentures were readily marketable. By its terms, page 3 of the proxy statement does not include such debentures. Plaintiffs do not contend that it was improper for such debentures to be accounted for as Investments in Schenley's audited financial statements. Similarly, since Schenley was an affiliate of Glen Alden, there can be no doubt that Schenley could not dispose of such securities without the preparation and filing of a registration statement as required by Section 5 of the Securities Act of 1933, 15 U.S.C.A. 77e.

4. It is a combination of all of the factors listed above —none of them concealed from shareholders—that account for the difference between page 3 of the proxy statement and the figure of $191 million selected by plaintiff. Not only is the difference of no significance, but it is apparent that the figures disclosed to shareholders on page 3 of the proxy statement are far more reflective of Schenley's actual cash position than the computations made by plaintiffs.

The Sources of Schenley's Cash

Plaintiffs' reliance on the figure of $191 million as Schenley's cash position as of May 31, 1971 is at best dubious. However, for the purpose of pointing out the sources of Schenley's liquidity, we will accept such figure.

Prior to the trial of this action, plaintiffs argued at great length in their Trial Memorandum and the Pre-Trial Order that the improvement in Schenley's cash position was the result of some secret liquidation program of inventories and accounts receivable—allegedly not disclosed—by defendants. This position has been abandoned as a result of the recognition that, since the improvement in Schenley's cash did not come from liquidations, much less secret ones, this allegation was doomed to failure. A review of Schenley's publicly disclosed balance sheets shows that the alleged $215 million improvement in liquidity (App. Br. p. 9) resulted from transactions that were fully disclosed to shareholders as follows:

1. $114 million is a result of the sale of Buckingham. There is no dispute that all facts concerning the sale were fully disclosed.*

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* Plaintiffs' attempt (App. Br. pg. 10) to identify the source of Schenley's improvement in liquidity (this time relying on the May 31, 1971 balance sheet) in a way, not surprisingly, that denigrates the amount of such improvement due to the sale of Buckingham. Plaintiffs' allocation of $24 million less than is fact to the sale of Buckingham is simply in error. Plaintiffs' other allocations, such as attributing amounts to the sale of Schenley's wine business (it had no effect in the May 31, 1971 balance sheet) are also erroneous and not supported by the record. One need only compare the balance sheets in this action to discover that the comparison set forth above is accurate and amply supported by all of the evidence introduced at the trial of this action.

2. $33.5 million is in fact not an improvement. Plaintiffs have excluded from Schenley's cash that sum which was held by Buckingham prior to the time it became a wholly-owned subsidiary of Schenley. It is not disputed that such sum existed throughout the period in question, that it was at all times included in Schenley's public financial statements, and that Schenley owned a majority (53%) interest in Buckingham.

3. The remainder is reflected in an increase in retained earnings, not including the gain from the sale of Buckingham, (Compare A1402 with A1256) and from other sources primarily the reduction of inventory. There can be no question that these matters are readily discernible from Schenley's public financial statements. Indeed, page F-27 of the proxy statement (A1042) specifically shows this reduction in inventory.*

The Decision of the District Court

A. The Proxy Statement Claims

Judge Owen's decision rendered on November 23, 1976, focused primarily on plaintiff's charges concerning Schenley's cash. The Court found that the Proxy Statement set forth the relevant facts about Schenley's cash position and

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* We note that plaintiffs have arbitrarily chosen an unaudited balance sheet of May 31, 1968 as the basis for comparison. If instead one chooses August 31, 1967 (A1255)—the last audit before Glen Alden obtained control of Schenley the alleged improvement is approximately $178 million.

the sources, primarily the sale of Buckingham, for the growth in such cash. The Court further held that the facts found in the proxy statement were adequate disclosure of the use of such cash. Finally, in light of the disclosures made in the proxy and the testimony at trial, Judge Owen found that plaintiffs' contention that the proxy statement should label such cash as "excess" was without merit.

B. The "Pendent" Claims

During the course of the trial on liability plaintiffs sought to introduce evidence attacking the fairness of the merger—the same evidence as would be introduced if there was a subsequent trial on damages. The basis for this offer was plaintiffs' alleged common law claim based upon pendent jurisdiction.* The District Court, as a matter of discretion, declined to accept evidence not related to plaintiffs' claims under the securities laws. However, the Court made it clear that any evidence relating to both a securities claim and a claim of unfairness would be accepted.

ARGUMENT

POINT I.

The District Court correctly held that the Proxy Statement was not materially false and misleading.

A. The Applicable Standards

Apparently, recognizing the strength of Judge Owen's numerous findings of fact, plaintiffs' initial argument (App. Br. pg.25) is devoted to an attempt to escape the requirement that under Rule 52(a), F. R. Civ. P., the District

* Plaintiffs contend for the first time on this appeal that this claim was based on diversity jurisdiction. As we will show below (Point II, infra), this claim is baseless.

Court's "findings of fact shall not be set aside unless clearly erroneous." *See, e.g. Corenco Corp.* v. *Schiavone & Sons, Inc.*, 488 F.2d 207, 211 (2d Cir. 1973).

Contrary to the plaintiff's protestations about the nature of the District Court's findings, in *Simon* v *Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 482 F.2d 880 (5th Cir. 1973), the Court of Appeals for the Fifth Circuit expressly confirmed that in a securities acts case, the "clearly erroneous" standard applies to a finding by the District Court "sitting without a jury," that a defendant "did disclose" sufficiently the allegedly omitted information:

> "The District Court found that Merrill Lynch's recommendations of SCC common stock were in no way "fraudulent or negligent or inaccurate in stating facts known by [the brokerage firm] about [SCC]," and that the evidence did not establish that Merrill Lynch was fraudulent or negligent in either its investigation of SCC or its representations about the Company. The Court specifically found that Simon "did not rely on [Merrill Lynch's representations] regarding these securities." The Court also found that Merrill Lynch did disclose to Simon, in the midst of his trading, its position as market maker in SCC common stock during the relevant period. Upon these findings, the Court held that Simon had failed to establish a claim against Merrill Lynch under the Securities Act or under common law fraud or negligence.
>
> *"Simon has not met his burden under Rule 52(a), F. R. Civ. P., of establishing as 'clearly erroneous' the trial court's findings. . . ."* (482 F.2d at 883)

In *Japhe* v. *A-T-O Inc.*, 481 F.2d 366 (5th Cir. 1973), an action predicated on alleged federal securities law viola-

tions in connection with a corporate merger, the District Court, *inter alia,* "found that there was no misrepresentation of a material fact or concealment of a material fact which induced" plaintiff to approve the merger (*Id.* at 369). In affirming judgment for defendant, the Court stated:

> "Finally, while paying lip service to the clearly erroneous test of Rule 52(a), Fed. R. Civ. P., on our review of the district court's fact findings, Japhe's briefs and arguments are predicated upon facts, inferences and conclusions that the trial court neither found nor was compelled to find. As we explained in *Movible Offshore, Inc.* v. *M/V Wilken A. Falgout,* 5 Cir. 1973, 471 F.2d 268, 271, "[t]he question is not simply whether the reviewing court would have found otherwise but whether the trial court could permissibly find as it did. The reviewing court should upset a finding only when it 'is convinced on the whole record that the finding does not reflect the truth and right of the case.' Wright, Federal Court § 96, at 432." See *Wolf* v. *Frank,* 5 Cir. 1973, 477 F.2d 467." (*id.* at 370)

See also, e.g., *Lodges 743 and 1746, Etc.* v. *United Aircraft Corp.,* 534 F.2d 422, 433 (2d Cir. 1975) "Under Rule 52(a) of the Federal Rules of Civil Procedure, we are bound by the factual findings of the district judge unless they are clearly erroneous. And although the district court's interpretation of the contract involves a question of law and is fully reviewable, to the extent that the interpretation depends upon extrinsic facts, we are bound by the findings of the lower court with respect to such facts" (534 F.2d at 433); *Pan American World Airways, Inc.* v. *Aetna Casualty & Surety Co.,* 505 F.2d 989, 1004 (2d Cir. 1974).

Plaintiffs also attempt to escape the requirements of Rule 52(a) by arguing that the District Court applied an

improper standard of law. There can be little question about the standard applied by Judge Owen. Judge Owen held that § 14(a) requires that the relevant facts be disclosed but does not require a particular choice of words or labels. This holding is is accordance with the standards applied by this and other courts.

It is clear that what is required is "disclosure of basic facts so that outsiders may draw upon their own evaluative expertise". *SEC* v. *Texas Gulf Sulphur Co.*, 401 F.2d 833, 849 (2d Cir. 1968) and not opinions, interpretations or conclusions. *Rosenblatt* v. *Northwest Airlines*, 435 F.2d 1121 (2d Cir. 1970).

> "The proxy provisions of Rules 14a-9 and 10b-5 are aimed at *disclosure of all material facts*, not at ensuring an exhaustive dispassionate, and evenly balanced presentation of conflicting interpretations of the facts given . . . it is enough if proxy material sets forth all the facts necessary to enable a reasonably intelligent stockholder to make his own informed decision. *Abramson* v. *Nytronics, Inc.*, 312 F.Supp. 519, 524 (S.D.N.Y. 1970).
>
> "Courts have opined that only 'facts' but not conclusions . . . must be revealed. Indeed, disclosure of vague generalities rather than facts can be objectionable." A. Jacobs, The Impact of Rule 10b-5, (1974), p. 3-16.*

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* Plaintiffs have given no recognition to the requirement that a proxy statement be judged as a whole which, in this case, includes the warnings and litigation descriptions found therein. *Rosenblatt* v. *Northwest Airlines*, 435 F. 2d 1121, 1127 (2d Cir. 1970), *Smallwood* v. *Pearl Brewing Company*, 489 F. 2d 579, 602 (5th Cir. 1974). The Supreme Court reaffirmed the validity of this rule in *TSC Industries, Inc.* v. *Northway Inc.*, [1976-77 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 95,615 (U.S.S.C., 1976).

Plaintiffs can cite no authority which holds that in a transaction—whether bitterly contested, supported by management or wholly intracorporate—there is a requirement that labels and conclusions—as opposed to material facts—be disclosed. Surely, *Blanchette* v. *Providence and Worcester Co.*, [1976-77 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 95,869 (D. Del. 1977), does not support such a proposition. Indeed, *Blanchette,* unlike the instant case, involved the omission of vital facts and not a quarrel about labels to be applied to disclosed facts.

In summary, the District Court applied the proper standards in evaluating this case. Measured against these standards, plaintiffs' evidence was wholly insufficient and the findings of fact and conclusions of law made by Judge Owen were proper.

B. Plaintiffs' Claims

Although plaintiffs' assertions basically focus on the issue of Schenley's cash, they are phrased in a variety of ways. We will deal with these variations on a common theme seriatim.

1. *Plaintiffs' Claim that there should have been an Additional Comparison of Schenley's Cash Position between 1968 and 1971.*

There is no question that Schenley's financial position, including its liquidity, was accurately set forth in the proxy statement. Similarly, there is no dispute that the proxy statement contained those financial statements required by the rules of the Securities Exchange Commission and that such financial statements were accurate. What plaintiffs have argued is that defendants were for some reason required to present a more extensive historical presentation of Schenley's financial condition and particularly its liquid-

ity. Just such an allegation was squarely rejected in *Corenco Corp.* v. *Schiavone & Sons, Inc.*, CCH Fed. Sec. L. Rep. ¶ 94,220 (S.D.N.Y. 1973). In *Corenco*, defendants presented financial statements for two years as was required. Plaintiffs contended that it would have been more appropriate to present financial statements for a longer period. The Court rejected this contention, stating:

> "While it is obviously true that 5 years' disclosure would present a fuller picture, such an argument can be made ad infinitum. The court requires only that disclosure be adequate, not that they meet some ideal."* (at 94,904)

See also *Alaska Interstate Co.* v. *McMillian*, CCH Fed. Sec. L. Rep. ¶ 95,276 at page 98,406 (D. Del. 1975).

But even if it were not sufficient to accurately present the financial information required by law, defendants more than fulfilled their obligation of setting forth those facts that could conceivably be important to an investor. Not only is Schenley's current cash position accurately presented, but those events which led to the increase in Schenley's cash position were concededly publicly and accurately reported. Thus, any investor could, by reviewing the financial information contained therein, as well as Schenley's other public financial statements, quickly ascertain not only the amounts by which Schenley's liquidity increased but the sources of such increase.

No shareholder could fail to see that Schenley at the time of the proxy statement had substantial cash. Indeed, this fact is particularly emphasized at p. 3 of the proxy

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* Plaintiffs erroneously suggest (App. Br. p. 30) that Judge Owen thought *Corenco* held that SEC reporting requirements were the only factors relevant to this issue. Judge Owen found as a fact, as did the District Court in *Corenco*, that two years financial statements were in fact adequate disclosure.

statement. No shareholder could be unaware that the sale of Buckingham had been the major source of Schenley's "cash rich" position. No shareholder could be unaware that Schenley's cash balances and investments had substantially grown, that its net worth had increased over several years, that its inventories had been reduced, and that Schenley had complete control over the cash previously owned by the Buckingham Corporation. If any shareholder desired he could make comparisons from 1968 by reviewing the Statement of Consolidated Changes in Working Capital found within the proxy statement.*

In short, as the District Court found, the facts necessary for any comparison that a shareholder might wish to make were presented.

2. *The Use of Schenley Cash after the Merger and the Amendment of the Schenley Loan Agreements.*

Plaintiffs contend that the proxy statement failed to make adequate disclosure of the uses to be made of Schenley's cash after the reorganization and that the proxy statement also should have disclosed that Schenley's lenders were willing to allow it to use as much as $115 million in cash in connection with the merger. Much of this argument is part and parcel of plaintiffs' contention that Schenley was required to render an opinion that it had "surplus" cash. A review of the facts and the disclosures made in the proxy statement demonstrates that more than adequate disclosure was made.

Plaintiffs cite the figure of $98 million as the amount of cash that was used in connection with the merger. Of

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* Although plaintiffs persist in advocating comparisons from 1968 it is apparent from their own exhibits (A1434) that even aside from the sale of Buckingham, Schenley's cash position primarily increased in 1969 and 1970. See App. Br. pg. 31 f.n.

that sum, it is undisputed that approximately $17 million was paid directly to the shareholders whom plaintiffs claim to represent. Plaintiffs have cited no reason, and we submit there is none, as to why it was necessary, material, or even relevant to discuss this sum of money, since the shareholders received the money directly, dollar for dollar. In essence then, plaintiffs claim rests upon the argument that there was inadequate disclosure of the amounts of money that were to be transferred by Schenley to Glen Alden upon the consummation of the reorganization. Before reviewing the nature and quality of that disclosure, we note briefly what are the undisputed facts about such transfer of money.

It was understood by the time of the merger that Schenley would purchase from Glen Alden at a discount the debentures to be issued to the minority shareholders (T 298). If all shareholders accepted the merger, then the total amount to be paid (at 80% of face amount) was approximately $81 million (A417). However, the net amount to be paid depended upon how many shareholders exercised their appraisal rights, since as provided in the agreement of merger (A1050), Glen Alden would return to Schenley the cash received for the purchase of any debentures attributable to dissenting shareholders (A417). At the time of the merger, Schenley purchased all of the outstanding debentures from Glen Alden for approximately $81 million (A110.10). In September, 1971, when the amount of shareholders seeking an appraisal was established, Glen Alden returned approximately $20 million of that sum to Schenley (A866). Thereafter, for a period of approximately 4 years, as people withdrew from the appraisal proceedings, Schenley would repurchase debentures from Glen Alden so that by the time of the trial of this action, approximately $75 million had been transferred from Schenley to Glen Alden (A1458).

Plaintiffs concede that the proxy statement made disclosures about the transfer of money from Schenley to Glen Alden (App. Br. p. 49) and cite portions of such disclosures. Before responding to plaintiffs' argument that such disclosures were inadequate, we shall set forth all of the disclosures made on this subject.

1. On the first page of the proxy statement the following paragraph appears in bold type: **"Schenley will transfer to Glen Alden substantial funds of Schenley, including a substantial part of the proceeds received by Schenley from the recent sale of its subsidiary, the Buckingham Corporation"** (A950). (Emphasis in original).

2. On page 3 of the proxy statement, the following language appears: *"The proposed reorganization will result in Glen Alden becoming the owner of all of the equity securities of Schenley (except the Schenley Preference Stock) and will permit Glen Alden to transfer funds from Schenley to itself, including a substantial portion of the proceeds of the recent sale of Schenley's subsidiary, The Buckingham Corporation ("Buckingham"), subject only to applicable restrictions in Schenley's various loan agreements. Subject to the consummation of the proposed reorganization and the said loan agreement restrictions, substantial funds of Schenley will be transferred to Glen Alden. These funds will initially be added to Glen Alden's general working capital and will provide a source for payment of current maturities of Glen Alden's long-term debt"* (A952). (Emphasis supplied).

3. On page 43 of the proxy statement, the following language appears: *"As is discussed above under 'Certain Significant Aspects of the Proposed Reorganization', upon the consummation of the proposed reorganization a substantial portion of the proceeds of the sale of Buckingham will be transferred to Glen Alden"* (A992). (Emphasis supplied).

4. The agreement of merger annexed to the proxy statement (A1049) reveals that Schenley will purchase the Glen Alden debentures and the proxy statement itself reveals the rate of discount on such debentures (A975).

5. Finally, there could be no doubt in the mind of any shareholder that after the consummation of this merger, Glen Alden would be the owner of all of the stock of Schenley and free to deal with its assets in whatever permissible way it deemed appropriate.

In light of the above disclosures, it is difficult to discern why plaintiffs contend that the proxy statement was deficient. Surely, there is no claim that the intention to transfer money was in any way concealed (compare *Gerstle* v. *Gamble-Skogmo, Inc.*, 478 F.2d 1281 (2d Cir. 1973), where this Court found liability because a proxy statement gave the impression that there would be no liquidation of assets when in fact such a liquidation was planned). It appears that plaintiffs claim that the proxy statement should have contained an exact number for the amount of cash to be transferred. Yet, any such number would have been pure speculation since the amount to be transferred depended upon the number of shareholders who sought appraisal in the Delaware courts. Thus, the use of the figure $81 million would have been wrong by approximately 25% since the net transfer from Schenley to Glen Alden in 1971 was only $61 million.

Basically, plaintiffs seem to complain that the disclosures in the proxy statement and the use of the word "substantial" were too indefinite to apprise shareholders of the amounts to be transferred. Plaintiffs argue that one could conclude that only $47 million was to be transferred—a figure much closer to the ultimate figure of $61 million than the number plaintiffs would use. However, such a reading is simply unreasonable. The proxy statement

makes it clear that not only will there be substantial funds transferred but that these funds will include a substantial part of the proceeds received from the sale of Buckingham, which proceeds total $120 million. The proxy statement made it equally clear that the payment of current maturities of long term debt of $47 million was only one use of the funds to be transferred. In light of the actual facts concerning the transfer of moneys this is more than sufficient disclosure even under the standards advocated by plaintiffs.

If there could be any doubt about the adequacy of disclosure concerning the transfers of money, such doubts are eliminated by reviewing the prior statements of plaintiffs (or their representatives) made when they were seeking to enjoin the merger. These statements (found in Exs. C, E and F A1462-1474) demonstrate that plaintiffs, relying on the disclosures made in the proxy statement not only were able to ascertain the amounts of money in question, but in fact, concluded that even more money was to be transferred than was in fact transferred. Thus, in Exhibit C, Mr. Glick, a principal of a plaintiff attacking this merger, stated after citing page 3 of the proxy statement: "The total amount thus being upstreamed would, in my opinion, be virtually all of Schenley's surplus cash—$155 million (A1465). In Exhibit E, counsel for plaintiffs before the Chancery Court of Delaware stated after citing the proxy statement: "Glen Alden is going to take unto itself 100% of this operating business and most important, 100% of [Schenley's] surplus cash" which he claimed was $155 million (A1469). Finally, in Exhibit F, Mr. Odell, counsel for plaintiffs in this action, after citing page 3 of the proxy statement, asserted that "all of the cash of Schenley will be passed up to Glen Alden" and identifies that cash as being in an amount of $200 million (A1472).

We suggest that these statements are a further demonstration—if any is necessary—that stockholders when read-

ing the proxy statement, had no trouble at all in ascertaining the magnitude of the funds to be transferred by Schenley to Glen Alden.

In a very real sense, it would appear that plaintiffs' entire position on this issue, as well as plaintiffs' claims that Schenley was obliged to opine that it had "excess" cash are based upon the proposition that the facts in this case are somehow so similar to those presented to the District Court in *Feit* v. *Leasco Data Processing Equipment Corp.*, 332 F. Supp. 544 (E.D.N.Y. 1971) that the *Feit* decision compels a finding of liability. A comparison of the facts of the instant action and *Feit* however demonstrates that plaintiffs' position is as devoid of legal merit as it is of factual foundation.

In *Feit,* the question of disclosure involved so-called "surplus surplus." This was a concept applied to insurance companies and referred to the amounts of cash that were not required by state regulation to be maintained as a reserve and thus were free for other uses. The balance sheet of Reliance (the target company in *Feit*) contained no separate entry for "surplus surplus" and one could not determine its existence, amount or any increase thereof by looking at the balance sheet.

There was no question in the *Feit* case that the acquisition and projected use of Reliance's "surplus surplus" was an important, if not the major, reason for the Leasco exchange offer. Leasco became interested in Reliance only after learning of the possible existence of surplus surplus. It carefully studied at least two reports dealing with such surplus surplus and had in its possession estimates of the present amount of this asset. It was highly unlikely that Leasco would have ever made its exchange offer were it not for the existence and potential use of this asset. Indeed, this was so important to Leasco that it specifically con-

tracted with the management of Reliance so that its interest in the "surplus surplus" could not be impaired. Finally, shortly after the consummation of the tender offer, Leasco, in an attempt to describe its business in a most favorable way, made it a point in a subsequent prospectus to specifically describe the "surplus surplus" and the possibility that Leasco could make use of that asset.

It is rather simple to describe the disclosures made by Leasco in its prospectus about this vital asset. Absolutely nothing was said. No estimate was made of "surplus surplus," no indication was given of its importance to Leasco and no statement was made that even implied that it was an important factor in the tender offer. Indeed, the existence of this asset was not even disclosed. This total absence of disclosure led the court to find liability concluding that disclosure should have been made even though any estimate of the amount of this asset would be highly qualified.

A comparison of the total lack of disclosure in *Feit* to the disclosures made in the present proxy statement about the monies to be transferred to Glen Alden demonstrates that the proxy statement was more than sufficient. In the first place, there is no evidence to indicate that such transfer was remotely as important to Glen Alden as the "surplus surplus" was to Leasco. While in *Feit,* even the existence of "surplus surplus" was something that an investor could not discern from the Reliance financial statements, it is clear that Schenley's cash, the magnitude of its increase in cash, and the sources of such cash,* were all adequately disclosed in the text and the financial information. Leasco said nothing about the importance of "surplus surplus" or its intentions

* As Judge Owen pointed out, "it is perfectly apparent from the proxy statement that a major independent self-sustaining asset of Schenley's (the Buckingham distilling operation) had been sold, and the proceeds now existed in cash . . ." (Op 8)

with regard thereto. Most significantly, the proxy statement is clear and unequivocal in stating that the funds of Schenley were intended to be and were in fact transferred to Glen Alden. Leasco made no disclosure that would have allowed a shareholder even to speculate as to the amount of such surplus surplus. As we have discussed above, the proxy statement here gives more than adequate information as to the amount of cash to be transferred.

In summary, *Feit* was a case where an absolutely essential fact was completely concealed. The instant action is a case where an arguably relevant fact was exhaustively disclosed.

It is apparently plaintiffs' position that the fact that the Schenley loan agreements were amended to permit Schenley to pay as much as $115 million in connection with the merger (A1403) is material to this lawsuit. The amendment in question took place on June 7, 1971, more than two weeks after the proxy statement was mailed. The evidence, which is undisputed, demonstrates that the figure of $115 million was inserted in the loan agreements simply to provide a margin for error and contingencies in connection with the proposed merger terms (A440). There is no evidence to suggest that this dollar figure had been arrived at prior to the time of the mailing of the proxy statement.

The relevance of this amendment is simply non-existent. It had nothing at all to do with the amount that was paid to shareholders.* The amount of money paid by Schenley was based upon the terms of the merger and the number of people who sought appraisal and that amount would not and did not change whether or not the loan agreements

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* Obviously, as Mr. Chernow testified (A428), an amendment was necessary to increase the amount permitted to be paid. Mr. Chernow also testified that he did not conclude that Schenley could or would pay out $115 million (A446-447).

permitted Schenley to pay $100 million, $115 million or $150 million.

3. *The Allegations about Excess Cash.*

All of plaintiffs' other allegations lead inexorably to their conclusion that the essential deficiency in the proxy statement was a failure to opine in haec verba that Schenley had "excess cash of $140 million". Plaintiffs extensively discuss their definition of "excess cash" offering a variety of figures and rationales. Plaintiffs also extensively discuss the alleged importance of their concept of "excess cash" while citing and apparently relying upon the prediction made in the Graham report (Ex. 5 A1268) and Greenberg affidavit* (Ex. 6 A1311) (App. Br. pp. 6-8).

It matters little what definition plaintiffs advocate or how they compute this "excess" cash. As we will show below, the testimony of plaintiffs' own expert refutes their claims. In any event, the proxy statement made more than sufficient disclosure of the relevant facts concerning Schenley's cash, its sources and its uses.

In order to analyze plaintiffs' claims, it is necessary to distinguish between the funds that were transferred to

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* Although both the Graham and Greenberg documents were admitted into evidence for a limited purpose (A204, 209), plaintiffs seek to make far more extensive use of these documents. Interestingly, while citing and apparently accepting the estimates of these gentlemen about Schenley's potential liquidity from the reduction of inventories and accounts receivable, plaintiffs ignore the fact that Mr. Graham's estimates proved to be inaccurate by more than $194 million and Mr. Greenberg's by more than $116 million (A-157-8) based upon comparing these Exhibits to Exhibit 17-B). As the Court noted in the Delaware appraisal proceedings *Gibbons* v. *Schenley*, 339 A.2d 460, 466 (Del. Ch. 1975) "[T]he expectations on realizing cash from the disposal of Schenley's inventories and the collection of its receivables were overestimated. By the merger date, Schenley's inventory had been reduced in an amount of $144 million less than had been anticipated while receivables had actually increased. . . ." Neither document suggested that Schenley sell Buckingham or that such sale would be advantageous.

Glen Alden and the remainder of plaintiffs' so-called $140 million of "excess cash". Plaintiffs' definition of "excess cash" is cash not needed in the day-to-day operations of Schenley*. We suggest that no reasonable person could fail to conclude that monies that were being transferred out of the corporation were no longer to be used in the corporation's day-to-day operations and that management in approving such transfer, had determined that such cash could be transferred without adversely affecting the business of the company. There is no suggestion that the proxy statement gave the impression that these sums were being merely loaned to Glen Alden to be returned if Schenley had some need for them. It is hardly necessary to enable an investor to make a decision for the proxy statement to not only state that the funds are being transferred, but also state that it was management's opinion that it was able to afford to make this transfer of funds. Using plaintiffs' definition of excess, the proxy statement clearly discloses that Schenley had excess funds which it was in fact transferring. Thus, to apply the label of "excess" is nothing more than an exercise in rhetoric.

With respect to the remainder of the $140 million, it is clear, as the District Court found, that even by plaintiffs' definition such cash cannot be denominated "excess." Thus, Mr. Dormer, the expert** upon whose testimony plaintiffs claim of "excess" cash rests, testified as follows: (A860-862)

> Q. If all of the cash, certificates of deposits, and marketable securities, and for the purpose of this

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* The tenuousness of plaintiffs' concept is illustrated by the fact that their definition would apparently preclude management from using cash for expansion or diversification of business.

** We are compelled to note that Mr. Dormer's compensation was apparently contingent (A805). See *Person* v. *The Association of the Bar of the City of New York*, Docket No. 76-7457 (2d Cir. April 29, 1977).

question I will use those three items and refer to them as cash, because they are cash or its equivalent, right?

* * *

Q. If all of the cash which I have just defined—
A. Right.

Q.—in Schenley, other than the amount which was used in connection with the reorganization, was in the best and honest and correct judgment of the management of Schenley required in the business of Schenley, would you in your expert opinion and under your definition of "excess" denominate such cash as excess?

* * *

Q. Did you hear my words of "honest" and "correct", and I will add another ingredient, "good faith"; if in the business judgment of management, the money or the cash, other than that which was used in the reorganization, was necessary in their judgment for the business of Schenley would you consider that "excess"? A. *No, sir.* Necessity. (Emphasis supplied).

The testimony of Mr. Chernow, which was not disputed, established that, by Mr. Dormer's definition, Schenley had no excess cash other than the moneys used in the merger. Mr. Chernow testified (A869-70):

Q. Mr. Chernow, what happened to the rest of that pool of cash and marketable securities? A. The rest of that pool was used in the business and operations of Schenley because it was necessary for the reduction of debt, for the payment of accounts payable, for the investment in added inventories, added receivables, and it continues until this day in con-

stant usage in the business and operations of our company.

Q. Was it the judgment of the management of Schenley that the money, the extra—that which was net sent up to Glen Alden or sent out to the shareholders was needed in the business of Schenley? A. Yes, it was.

Q. Is that a judgment made by the management? A. Certainly was.

Q. And all of that money has to this day been used in the business of Schenley, is that correct? A. Yes, sir.

Even if we assume that the concept of "excess" cash, as defined by plaintiffs, had some meaning, it is clear that the proxy statement disclosed the facts that would enable any shareholder to reach the appropriate conclusion on that subject. Most significant in this respect is the complete disclosure concerning the sale of Buckingham. Each shareholder knew that Buckingham had been sold for $120 million and that this company had been replaced by cash. There is no suggestion in the proxy statement that Schenley had any plans or need to use the proceeds of the sale in the expansion or diversification of its business (see A813). Similarly, as Mr. Dormer admitted, it is clear that Schenley would and could operate as a viable company without the Buckingham operation (A860).

At the same time, the proxy statement contains full and accurate information about the prior operations of Schenley, its cash position and its debt level. Any shareholder could review this information and draw his own conclusions as to what was needed in the business, what was required to pay debt, or how much cash was available for other purposes. Certainly, any shareholder could compare Schen-

ley's balance sheet with the public financials of other companies, the same analysis performed by Mr. Dormer in order to reach his conclusion about "excess" cash (A806).*

That the disclosure in the proxy statement provided more than enough information for a shareholder to make a determination about "excess" cash is once again demonstrated by the plaintiffs themselves. In 1971, when plaintiffs were seeking to enjoin this merger, they readily concluded just from reading the proxy statement that Schenley had "excess" cash. Mr. Goldstein, Mr. Glick and Mr. Levy, (Exhibits C, D and E) all asserted that Schenley had such "excess" cash and estimated that amount at $155 million while Mr. Odell (Exhibit F) estimated the amount at $200 million. Significantly, all specifically based their estimates upon the disclosures found in the proxy statement.

Thus, the proxy statement provides all of the facts relevant to this issue. By definition, the decision in *Feit,* where shareholders had no information by which they could reach any conclusion about surplus, is inapplicable.

4. *Glen Alden's "Opinion" about the Value of Schenley.*

It is apparently plaintiffs' position that footnote D to the Glen Alden financial statement—included in the proxy statement (A1028)—dealing with intangibles represents an opinion of Glen Alden that the stock of Schenley was worth approximately $60 per share and that the proxy statement failed to make adequate disclosure of this "opinion". Of course, the proxy statement fully disclosed the original price paid by Glen Alden for its investment in Schenley and the footnote itself is, of course, present in the proxy statement.

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* Plaintiffs now suggest for the first time (App. Br. p. 31) that the proxy statement should have contained such comparative financials. Not surprisingly, no authority is offered for this proposition.

Plaintiffs discuss at great length the authorities applicable to a disclosure of valuations. We need not debate the relevance of these authorities since there was no valuation. In order to make this argument and characterize the footnote as some sort of expression of opinion regarding value, it is necessary for plaintiffs to ignore the undisputed testimony at trial which they themselves elicited.

The testimony of Mr. Gummer of Haskins & Sells (auditors for Glen Alden) established the following: (1) this footnote is a common footnote for the treatment of intangibles (A622) and had been present on Glen Alden's financial statements before it made any investment in Schenley (A619); (2) the accounting treatment involved nothing more than allocating the cost of Glen Alden's purchase of Schenley between the book value of Schenley as reported on Schenley's books and the excess cost or "intangible" resulting from Glen Alden's purchase of Schenley (A620-621); (3) such accounting treatment is not changed unless an event occurs which so seriously and permanently impairs the value of Schenley as a going business—such as the destruction of a major asset—that a writedown is required (A591-A594)*; and (4) the only event that occurred within the scope of this footnote was the sale of Buckingham at which time the intangible was partially written down, whereas the merger was not such an event (A604, 623).** Finally, and most importantly, neither the accounting treatment nor the footnote itself purport to relate to a valuation of Schenley stock, but turn solely on the cost of purchase of Schenley (A621, 589-90).

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* Indeed, Mr. Gardner, plaintiffs' accountant, testified that this accounting treatment is not changed, except at the time of a reorganization (T 743).

** If plaintiffs' concept of this footnote as a valuation of stock were correct, then the proposed merger terms of $29 would lead to a writedown of the intangible. In fact, the merger led to an increase in the intangible (A623).

Thus, footnote D had no relevance to any valuation of Schenley stock, much less the stock of the minority shareholders in question. There was no opinion of Glen Alden to disclose to shareholders.

5. *Plaintiffs' Other Arguments.*

Plaintiffs' brief to this Court is replete with comparisons, suggestions and formulations of alternate language that could have been inserted in the proxy statement. Little need to be said about these proposals which involve circumstances quite different from those presented at the time of the proxy statement. Such argument is a prime illustration of the wisdom of the rule that "[M]ere failure to say everything on this score that opponents of the merger would have wished is not such an omission 'to state any material fact necessary in order to make the statement therein not false or misleading', under Rule 14a-9", *Rosenblatt* v. *Northwest Airlines, supra,* (at 1128); see also *Abramson* v. *Nytronics, supra, Nanfito* v. *Tekseed, Hybrid Co.,* 473 F.2d 537 (8th Cir. 1973).

We also note, briefly plaintiffs' argument (App. Br. p. 48) — made for the first time on this appeal — that the proxy statement somehow concealed the effect of Glen Alden becoming the owner of 100% of the stock of Schenley. The pro forma financials found in the proxy statement (A974) makes a concise presentation of the financial effects of the merger including the effect on Glen Alden. In any event, plaintiffs' arithmetic—based on the erroneous assumption that Glen Alden only owned 68% of Schenley when for financial reporting purposes it owned 86%—is no more than an exercise having no economic substance to Schenley shareholders or anyone else.

Finally, we should briefly discuss the arguments plaintiffs have offered in support of their contention that the

alleged non-disclosures in this case satisfy the test of materiality set forth in *TSC* v. *Northway, supra.* First, plaintiffs seem to contend that disclosure about excess cash would induce shareholders to take advantage of Delaware appraisal proceedings presumably so that their stock would be valued on the basis of that excess cash. In fact, the court in *Gibbons* v. *Schenley, supra,* gave no recognition to this concept and excluded asset value from any weight in valuing Schenley stock. Plaintiffs do not claim that disclosure about "excess" cash might have led to the merger being enjoined since, as we have previously noted, just such claims about "excess" cash were part of the unsuccessful attempts to enjoin the merger. Nor have plaintiffs explained how, if the proxy statement "lulled" shareholders, approximately 1,000,000 shares were originally submitted for appraisal (A110).*

Plaintiffs' final attempt to establish materiality is to present theories of valuation of stock which denigrate market price and accentuate the value of cash. On three occasions, courts have been confronted with such arguments with respect to this merger and have rejected them. *Voege* v. *Smith, supra, Greene* v. *Schenley, supra, Gibbons* v. *Schenley, supra.* In this connection, we should note the recent statement of the Court in *Mills* v. *Electric Auto-Lite Co.,* [Current] CCH Fed. Sec. L. Rep. ¶ 96,035 (7th Cir. 1977).

> "We hold that when market value is available and reliable, other factors should not be utilized in determining whether the terms of a merger were fair" (at 91,647).

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* Plaintiffs have gone completely outside the record to argue that there is some significance to the fact that two claimants in the appraisal proceedings were former insiders of Schenley who left in 1968. They fail to explain how persons who left Schenley in 1968 had any particular insights into the generation of "excess" cash which, plaintiffs admit, did not occur until subsequent years.

POINT II.

The District Court properly declined to exercise pendent jurisdiction over plaintiffs' alleged common law claim.

Plaintiffs have contended that the terms of the merger were unfair and that they were maintaining a common law claim under the law of Delaware for damages for such "unfairness." On the second day of the trial, the District Court ruled that it would not take pendent jurisdiction over this claim. Plaintiffs now attack this ruling.

At the outset, we can quickly dispose of plaintiffs' contention that there was diversity jurisdiction over such claims. Plaintiffs offered no proof of residence of any party to this lawsuit, indeed, the word diversity was never mentioned at trial.* The Pre-Trial Order of February 1, 1975 clearly stated that the plaintiff claimed jurisdiction under the Securities Exchange Act of 1934 and pendent jurisdiction; again, no mention of diversity. If plaintiffs ever asserted a diversity claim, it clearly has fallen for a failure of proof.

Judge Owen's consideration of these pendent claims was set forth at considerable length in the transcript of the trial (A327-350, 370-374). A review of the transcript demonstrates that he considered the factors relevant to the exercise of his discretion, including the viability of these claims, the status of state court proceedings**, the nature of the proof involved and the considerations of judicial

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* In fact, plaintiffs failed to even establish that they were shareholders of Schenley, a clear prerequisite to their claim.

** Plaintiffs incorrectly state that Judge Owen felt bound by these decisions and argue that this was erroneous because they were not res judicata. (App. Br. p. 57) It is clear that the District Court only reviewed these decisions insofar as they bore on the exercise of his discretion.

economy engendered by the fact that proof concerning unfairness was vastly different from the evidence being presented at the trial on liability. On the basis of these factors, the Court declined to exercise pendent jurisdiction. That decision was correct and within the proper exercise of the Court's discretion.

As the Supreme Court said in *United Mine Workers* v. *Gibbs,* 383 U.S. 715 (1966), the power to hear pendent state claims

> "need not be exercised in every case in which it is found to exist. It has consistently been recognized that pendent jurisdiction is a doctrine of discretion, not of plaintiff's right." 383 U.S. at 726.

Accord, Moor v. *County of Alameda,* 411 U.S. 693 (1973); *Kavit* v. *A. L. Stamm & Co.,* 491 F.2d 1176 (2d Cir. 1974); *Rogers* v. *Valentine,* 426 F.2d 1361, 1363 (2d Cir. 1970).

Gibbs identified several factors which federal courts should consider in determining whether or not to take pendent jurisdiction of state claims. Among these are considerations of comity, judicial economy, and convenience. *United Mine Workers* v. *Gibbs, supra,* 383 U.S. at 726.

Considerations of comity alone justified the District Court's refusal to hear plaintiffs' fairness claim. The Delaware courts, at the time of this trial, had ruled that the proper remedy for the Schenley minority shareholders was an appraisal proceeding. In *David J. Greene & Co.* v. *Schenley Industries, Inc., supra,* the Court stated:

> "[U]nless the fair value of Schenley stock is so much greater than the total amount offered . . . then it would appear that the parties are merely in dispute as to value, for which an appraisal should be adequate. . . . If plaintiffs and others are not satisfied with the value placed on their shares by Glen Alden,

> and no fraud or blatant overreaching is demonstrated, their recourse is to an appraisal." (281 A.2d at 33, 35.)

The District Court would have been required to apply Delaware law to the very same issue, involving the same facts and circumstances, which a Delaware court had already decided. In order to hear plaintiffs' fairness claim, the federal court would have had to make a determination—that appraisal was not the proper remedy—contrary to the Delaware court's ruling as well as relitigating the valuation questions that had been presented in Delaware. Thus, a determination of fairness by the District Court would have been a "needless decision" of state law. Such needless decisions, the Supreme Court has said, should be "avoided both as a matter of comity and to promote justice between the parties. . . ." *United Mine Workers* v. *Gibbs, supra,* 383 U.S. at 726. See also *Meyerhofer* v. *Empire Fire and Marine Insurance Company,* 73 Civ. 1940 (S.D. N.Y. 4/12/77). (Pendent claim particularly appropriate for resolution by state court).

As the Supreme Court recently stated in *Santa Fe Industries, Inc.* v. *Green,* 45 U.S.L.W. 4317 (March 23, 1977), "The Delaware Legislature has supplied minority shareholders with a cause of action in the Delaware Court of Chancery to recover the fair value of shares allegedly undervalued in a short-form merger." *Id.* at 4321. The Court emphasized the preeminent role of the states in regulating the internal affairs of corporations, and it declared that "once full and fair disclosure has occurred, the fairness of the terms of [a merger] is at most a tangential concern of the [Securities Exchange Act]." *See Popkin* v. *Bishop,* 464 F.2d 714 (2d Cir. 1972). See also *Dreier* v. *The Music Makers Group, Inc.,* CCH Fed. Sec. L. Rep. ¶ 94,406 (S.D.

N.Y. 1974), where the Court stated in dismissing a claim of unfairness based on alleged pendent jurisdiction.

> "[T]he treatment of the minority shareholders may well have been grossly unfair but it was completely open. Under these circumstances plaintiff's remedy is a state court action for appraisal pursuant to the Delaware Corporation Law. *It should be noted that such an action for appraisal would not be properly before this court under concepts of pendent jurisdiction. The complicated accounting procedures attendant to an action for appraisal are totally collateral to any federal action. . . .*" (emphasis added).

Id. at 95,410.

The District Court was also justified in declining pendent jurisdiction because of the amount of additional time and energy which would have been needed to resolve the alleged state claims. *United Mine Workers* v. *Gibbs, supra,* 383 U.S. at 726. *Accord, Moor* v. *County of Alameda, supra,* 411 U.S. at 716. In this case resolution of the so-called fairness issue would have significantly lengthened the trial and burdened the court with considerably more testimony and evidence than was necessary for the trial of the federal claims. There can be no question—and plaintiffs do not contend otherwise—that the so-called fairness claim would have involved a body of proof wholly different from what was presented at trial. Indeed, no evidence, even if related to fairness, was excluded by Judge Owen if it related to disclosure claims.

Examination of the decision in *Gibbons* v. *Schenley Industries, Inc., supra,* indicates the scope of the detailed and complex evidence and testimony which would have been required to try the plaintiffs' fairness claim. In *Gibbons,* the court considered *inter alia* such factors as the signifi-

cance of the sale of Rosensteil stock in 1968, the history of Schenley's business, the nature of the business, the ratio of market price to earnings of its shares over a period of several years, the signifiance of a sale of a large subsidiary, the earnings of comparable businesses, Schenley's prospects and trends and, of course, extensive expert testimony. A trial on "fairness" would not only be a repetition of *Gibbons,* but would have involved the same proof that was determined to be excluded by bifurcating the issues of liability and damages. Considerations of judicial economy and convenience clearly warranted the exercise of the District Court's discretion in declining to hear the state claim.

Plaintiffs' only response to these considerations is to argue that since the case was so far along and there had been extensive discovery, it was somehow unfair to not hear their claim* and cite *Hirsch* v. *duPont,* 396 F.Supp. 1214 (S.D.N.Y. 1975). But *Hirsch* did not involve a merger, nor did it require a complex analysis to determine the value of corporate stock. The state and federal claims there were nearly identical—both alleged omissions and misrepresentations in the inducement to purchase securities—and involved the same scope of proof. The court there found that the plaintiffs "would ordinarily be expected to try their interrelated state and federal fraud claims in a single action." *Hirsch* v. *duPont, supra,* 396 F.Supp at 1229.

The mere fact that there has been extensive pre-trial activity is certainly not sufficient reason to compel a court to exercise pendent jurisdiction when other factors militate against it. As this Court said in *Kavit* v. *A.L. Stamm &*

* It is apparent from reviewing the Pre-Trial Order of February 9, 1975 and the course of discovery that scant attention was paid to this claim. Indeed, throughout the course of discovery, it was defendants position that a claim of unfairness was not properly before the Court.

Co., supra, referring to the fact that "the parties and the court had both invested a significant amount of time" in the case by the time it went to trial:

> "[I]t would have been well within the judge's discretion to refuse to consider the state claims even at that late stage. . . ." *Kavit* v. *A. L. Stamm & Co., supra,* 491 F.2d at 1183.

In fact, in *Kavit* the Court strongly indicated that the claim should not have been heard, despite the amount of time and energy invested by the court and parties in the case. *Id.* at 1183-84. Indeed, this Court has approved the dismissal of a pendent claim even after trial. *Rogers* v. *Valentine,* 426 F.2d 1361 (2d Cir. 1970). See also *Meyerhofer* v. *Empire Fire and Marine Insurance Company,* 73 Civ. 1940 (S.D.N.Y. 4/12/77).

In the final analysis, assertion of pendent jurisdiction, where the court has the power to do so, is a matter of the court's discretion, not of the plaintiff's right. E.g. *Moor* v. *County of Alameda, supra*; *United Mine Workers* v. *Gibbs, supra; Kavit* v. *A.L. Stamm & Co., supra; Rogers* v. *Valentine, supra.* Only in rare circumstances will an appellate court overrule a lower court's decision not to hear a pendent state claim. *Cf. Kavit* v. *A.L. Stamm & Co., supra,* 491 F.2d at 1180 n.5.* The District Court's determination was well within its discretion and should be sustained.

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* *Hagans* v. *Lavine,* 415 U.S. 528 (1974), cited by plaintiffs, is inapposite. That case involved a pendent federal claim, and the Supreme Court was careful to distinguish the case from *Gibbs* on that basis. Plaintiffs' citation of *Hagans* omits the following language of the Court:

> "But *Gibbs* was oriented to state law claims. . . . Pendent jurisdiction over state claims was described as a doctrine of discretion not to be routinely exercised without considering the advantages of judicial economy, convenience, and fairness to litigants." *Hagans* v. *Lavine, supra,* 415 U.S. at 545.

Finally, quite aside from the District Court's appropriate exercise of discretion, it was proper to dismiss the claim of "unfairness" since such a claim is invalid under the law of Delaware. Prior to and during the trial defendants asserted that the exclusive remedy for a claim of unfairness under Delaware law was a statutory appraisal proceeding. This argument was based upon the decision in *Greene* v. *Schenley, supra* (see p. 5 *supra*) and other Delaware decisions. See for example *Stauffer* v. *Standard Brands, Inc.*, 178 A.2d 311 (Del. Ch. 1962):

> "Plaintiffs' only challenge to the validity of the merger relates to the fairness of the price per share offered to minority stockholders as the final step to make the merger of Planters of Delaware into Standard Brands effective. Where this is the situation in a § 253 merger, that is, a dispute as to the value of the shares, or the adequacy of the price offered, the stockholder's remedy ordinarily lies in an appraisal proceeding under §262. (178 A.2d at 312);

Federal United Corp. v. *Havender*, 11 A.2d 331, 343 (Del. Sup. Ct. 1940). See also *Bruce* v. *E. L. Bruce Co.*, 174 A.2D 29, 30 (Del. Ch. 1961) ("Bruce stockholders have no alternative but to ask for their appraisal rights"); *Bastian* v. *Bourns, Inc.*, 256 A.2d 680 (Del. Ch. 1969), *aff'd per curium*, 278 A.2d 467 (Del. Sup. Ct. 1970); *Sterling* v. *Mayflower Hotel Corp.*, 89 A.2d 862 (Del. Ch.), *aff'd*, 93 A.2d 107 (Del. Sup. Ct. 1952).

Although the holdings of these cases was clear, none involved a post-merger claim for damages in a case like the one at bar. However, the Delaware courts have now made clear, in a case squarely in point, that any claim for unfairness is limited to a claim in a statutory appraisal proceeding.

In *Singer* v. *Magnavox Company,* 367 A.2d 1349 (Del. Ch. 1976), former shareholders of Magnavox Corporation sued to rescind a merger and recover damages. They alleged, inter alia, fraud and breach of fiduciary duty by the officers and directors by their failure to disclose, in the proxy statement, the inadequacy of the price offered for the dissenters' shares. In dismissing plaintiff's complaint for failure to state a claim, the court said:

> "It seems to me that despite the various ways in which plaintiffs attempt to allege fraud and self-dealing by defendants, these remaining allegations . . . reduce themselves to one thing, namely, that at $9.00 per share they were not paid the true value of their stock pursuant to the terms of the merger which the defendants collectively engineered. Thus, they seek to set aside the merger as being fraudulent because the cash price per share to be paid to minority shareholders was inadequate.
>
> When this is the basis for objection to a corporate merger, it is established law that the remedy of the dissatisfied shareholders is to seek an appraisal of the value of their shares pursuant to the procedures set forth under the appraisal statute, 8 Del. C. § 262." (367 A.2d at 1361-62.)

POINT III.

The District Court correctly dismissed the claims asserted by plaintiff Voege.

Although plaintiff Voege did not participate in the trial of this action, he has asserted claims both in the District Court and on this appeal. Basically, there are two claims; the so-called "third party beneficiary claim"

and an assertion that the merger in question was invalid under the laws of Delaware. We will deal with these claims seriatim.

At the outset, we should note that there is simply no jurisdictional predicate for plaintiff Voege's "third party beneficiary claim". No allegations have been made of fraud or deception (see *Santa Fe Industries* v. *Green,* 45 U.S.L.W. (March 23, 1977) sufficient to constitute a claim under the securities laws. Similarly, diversity jurisdiction has been neither pleaded nor proven. For this reason alone, it was proper to dismiss this claim.

In any event, it is clear that the "third party beneficiary claim" was totally without merit. Plaintiff's basic premise is that Glen Alden had agreed to make an offer to all common stockholders of Schenley to purchase their stock at a price equal to or in excess of that paid Mr. Rosenstiel in March, 1968. Whatever the merits of this premise, it is beyond dispute that in 1968 Glen Alden made just such an offer (A1172 *et seq.*). As the District Court found, (and as Judge Lasker found in denying plaintiff Voege's motion for a preliminary injunction, *Voege* v. *Smith, supra,* 329 F.Supp. 180 (S.D.N.Y. 1971)) this offer satisfied any claim plaintiff Voege might have had.

The second part of plaintiff Voege's argument, that the merger was invalid under Delaware law, is equally without merit. The courts of Delaware have specifically found this merger to be valid and legal and have permitted its consummation, *Greene* v. *Schenley, supra,* 281 A.2d 30 (Del. Ch. 1971). Indeed, since that decision, the Delaware courts have again held that a merger pursuant to § 251 of the Delaware Corporation Law, where shareholders receive cash in exchange for their securities, is valid under the laws of Delaware, *Singer* v. *Magnavox, supra,* 367 A.2d 1349 (Del. Ch. 1976).

CONCLUSION*

The District Court's findings of fact were more than amply justified by the evidence presented at trial. As the District Court found, plaintiffs have failed to prove any violation of the securities laws. The remaining claims asserted at trial and on this appeal are equally without merit. The judgment of the District Court should be affirmed.

Respectfully submitted,

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* In addition to the matters set forth above, defendants Paul A. Johnston, Walter R. Heinze, Russel G. Smith, Milo B. Hopkin and Albert N. Greenfeld, the "outside directors" submit that the Court below, properly decided the issues as to them on the further grounds that the plaintiffs offer no proof against the "outside directors" and no one even mentioned their names at trial. In their reply to Defendants' Post-Trial Memorandum, plaintiffs consented to the dismissal of Mr. Heinze as a defendant.

Service of three (2) copies of the [illegible]
is admitted this 27th day of May 1977

~~Zimet Hanes Moos & Goodkind~~ ~~Barbara Less~~
HERMAN ODELL

Charles TRYNIN Charles Trynin